In the Supreme Court
OF THE
United States

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OCTOBER TERM, 1938

No. 213

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY (a corporation),

Appellant,

vs.

JOHN C. CORBETT, FRED E. STEWART, RICHARD E. COLLINS, WILLIAM G. BONELLI and HARRY B. RILEY, as members of the State Board of Equalization of the State of California, STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA and U. S. WEBB, the Attorney General of the State of California,

Appellees.

Appeal from the District Court of the United States for the Northern District of California.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

PRELIMINARY STATEMENT.

OPINIONS BELOW.

The opinion of the District Court on the motion to dismiss the bill of complaint is not reported; its opinion on final hearing is reported in 23 F. Supp. 197. These opinions, however, are scarcely more than memoranda. They refer, for much of their discussion, to the opinions in the case of *Southern Pacific Company v. Corbett, et al.*, No. 212, October Term, 1938, reported at 20 F. Supp. 940 (on motion to dismiss) and 23 F. Supp. 193 (on final hearing), which was heard at the same time as this case.

JURISDICTION.

The statement as to jurisdiction has been filed, and this Court has made an order noting probable jurisdiction (October 10, 1938).

STATEMENT OF THE CASE.

Appellant, The Pacific Telephone and Telegraph Company, brought this suit to restrain appellees, state officers, from collecting the California use tax with respect to certain property used in appellant's interstate and intrastate telephone and telegraph business (hereinafter the word "telephone" is used for "telephone and telegraph").

Appellant contends that the use tax statute, as here sought to be applied by appellees, is invalid under the commerce clause. Equity jurisdiction is invoked upon the ground that appellant has no adequate remedy at law. We do not anticipate that the existence of equity jurisdiction

will be questioned by appellees in this Court, and we therefore pass that subject with a reference to the opinion of the trial court (20 F. Supp. 944-945, R. 44-45) and to the summary of facts and the authorities cited in our Statement as to Jurisdiction (pp. 3-4).

Pertinent provisions of the use tax statute (Cal. Stats. 1935, ch. 361, p. 1297) are quoted in the appendix. This statute imposes an "excise tax" of three per cent of the sales price on "the storage, use or other consumption in this State of tangible personal property purchased from a retailer", except property with respect to which a tax has been paid under the California Retail Sales Tax Act (Cal. Stats. 1933, ch. 1020, p. 2599). By this exception the Act is restricted in its scope to property purchased in another state and thereafter stored, used, or consumed in California. The tax is a flat rate tax, without apportionment or allowance for any division of use between intrastate and interstate commerce. Also, and unlike the Washington use tax considered by this Court in *Henneford v. Silas Mason Co.* (1937) 300 U. S. 577, it contains no provision for credit or exemption equaling the amount of sales or use taxes paid in other states.

The property here in question is telephone equipment purchased for the sole purpose of use in appellant's telephone system (Findings 9, 10, 16; R. 88, 90). This system renders an inextricably intermingled interstate and intrastate service, the same facilities being used indiscriminately for interstate and intrastate messages.

A part of the property, referred to in the record as **specific order equipment,**[1] consists of special equipment

[1]Emphasis by bold-face type or italics is ours throughout the brief unless otherwise stated.

which, upon arrival in California, is immediately installed and used in rendering telephone service (Findings 25, 26; R. 95-96). The rest of the equipment consists of stand-by facilities, which are kept at various points in the system for repair, replacement, or emergency service (Findings 29, 32, 33; R. 97, 98). All of the property, both specific order and stand-by, is specially designed and manufactured for use in a telephone system and is not suitable for any other use (Findings 23, 29; R. 94, 97).

A District Court of three judges (Jud. Code, sec. 266; U.S.C. 28:380) denied a motion to dismiss the bill and awarded an interlocutory injunction (R. 35-37), holding that, on the facts stated in the bill, the tax was invalid (20 F. Supp. 940; R. 37 et seq.). On final hearing the case was "submitted under an agreed statement of facts which sustains the pertinent allegations of the bill" (23 F. Supp. 194, 197; R. 79, 78), and the Court made findings accordingly (R. 85-103). The findings are summarized in the appendix.

Notwithstanding the findings, the Court decided for defendants (R. 78, 79-84). It reversed the ruling of law made in its first opinion and held that under the authority of three decisions rendered by this Court after the denial of the motion to dismiss, the tax was valid.

SPECIFICATION OF ERRORS.

The District Court erred:

1. In concluding as a matter of law that the imposition of the California use tax upon the acts and transactions found to have occurred with respect to the tangible per-

sonal property described in the findings of fact, after the termination of the interstate transportation thereof, would not be a direct burden upon the interstate commerce and business of the appellant.

2. In concluding as a matter of law that the imposition of the California use tax upon the acts and transactions found to have occurred with respect to the tangible personal property described in the findings of fact, after the termination of the interstate transportation thereof, would not be contrary to or in violation of the provisions of clause 3 of section 8 of Article I of the Constitution of the United States and the rights, privileges and immunities of the appellant thereunder.

3. In concluding as a matter of law that appellant's application for a permanent injunction should be denied and the bill of complaint dismissed.

4. In failing and refusing to conclude as a matter of law, as requested by the appellant, that the imposition of a use tax upon the acts and transactions found to have occurred with respect to the tangible personal property described in the findings of fact, after the termination of the interstate transportation thereof, would be a direct burden upon the interstate commerce and business of the appellant.

5. In failing and refusing to conclude as a matter of law, as requested by the appellant, that the California Use Tax Act of 1935 (Cal. Stats. 1935, p. 1297), if applied to any act or transaction found to have occurred with respect to the specific order equipment described in the findings of fact, after the termination of the interstate transportation thereof, would impose a direct tax upon

the operation of an instrumentality of interstate commerce.

6. In failing and refusing to conclude as a matter of law, as requested by the appellant, that the California Use Tax Act of 1935 (Cal. Stats. 1935, p. 1297), if applied to any act or transaction found to have occurred with respect to the stand-by facilities described in the findings of fact, after the termination of the interstate transportation thereof, would impose a direct tax upon the operation of an instrumentality of interstate commerce.

7. In failing and refusing to conclude as a matter of law, as requested by the appellant, that the California Use Tax Act of 1935 (Cal. Stats. 1935, p. 1297), if construed and applied by the appellees so as to impose a tax upon the acts or transactions, or any of them, found to have occurred with respect to the tangible personal property described in the findings of fact, after the termination of the interstate transportation thereof, is contrary to and in violation of the provisions of clause 3 of section 8 of Article I of the Constitution of the United States and the rights, privileges and immunities of the appellant thereunder.

8. In failing and refusing to conclude as a matter of law, as requested by the appellant, that appellant is entitled to a permanent injunction as prayed for in its bill of complaint.

9. In decreeing that appellant's application for a permanent injunction be denied.

10. In decreeing that appellant's bill of complaint be dismissed.

SUMMARY OF ARGUMENT.

The California Use Tax Act cannot validly be applied to the use of telephone property in intermingled interstate and intrastate commerce, such a tax being a direct tax upon the operation of instrumentalities of interstate commerce, falling indiscriminately and without apportionment upon the interstate as well as the intrastate use (*Helson and Randolph v. Kentucky* (1929) 279 U. S. 245; *Bingaman v. Golden Eagle Lines* (1936) 297 U. S. 626; *Cooney v. Mountain States Tel. Co.* (1935) 294 U. S. 384, 393).

The trial court's ruling that the tax may be applied to the **storage** of property prior to interstate use does not support the court's decree as to the **specific order equipment**, because there is no storage of that property prior to its use in intermingled interstate and intrastate commerce. Likewise, as to the **stand-by property**, there is no preliminary intrastate storage separable from use in the intermingled commerce, since it is true in every practical sense, as the trial court specifically found, that the stand-by service in this case is itself a necessary **use** of the property in the appellant's intermingled interstate and intrastate business.

There is in this case no intrastate enterprise, transaction, or use which is separable from the interstate use of the property. The tax upon the use of the property in suit, either in the immediate rendition of service (specific order equipment) or in a stand-by capacity (stand-by facilities), is, therefore, a direct tax upon interstate commerce. The state statute, properly construed, did not intend to impose such a tax, but if it

is otherwise construed, it is unconstitutional in that respect.

ARGUMENT.

A. SINCE THE PROPERTY IN QUESTION IS USED IN INTERMINGLED INTERSTATE AND INTRASTATE COMMERCE, AND SINCE THERE IS NO "STORAGE, USE OR OTHER CONSUMPTION" THEREOF IN CALIFORNIA, EXCEPT AS PART OF SUCH INTERMINGLED COMMERCE, THE USE OF THE PROPERTY CANNOT CONSTITUTIONALLY BE SUBJECTED TO A FLAT RATE TAX, WITHOUT APPORTIONMENT FOR THE DIVISION OF USE BETWEEN INTERSTATE AND INTRASTATE COMMERCE.

As already stated, the trial court filed an opinion denying the motion to dismiss and awarding an interlocutory injunction, in which it held that upon the facts stated by the complaint the tax was invalid. On the final submission it found the facts to be in accordance with the complaint, but reversed its ruling on the law and upheld the tax.

1. **General principles**—The trial court's first opinion was based upon principles which it considered to be well settled and which, we submit, are well settled.

> "A tax, which falls **directly** upon the use of one of the means by which commerce is carried on, **directly** burdens that commerce" *(Helson and Randolph v. Kentucky* (1929) 279 U. S. 245, 252).[2]

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[2]See also *Bingaman v. Golden Eagle Lines* (1936) 297 U. S. 626, 628; *Gregg Dyeing Co. v. Query* (1932) 286 U. S. 472, 479; *Eastern Air Transport v. Tax. Comm.* (1932) 285 U. S. 147, 153; *Postal Telegraph Cable Co. v. Adams* (1895) 155 U. S. 688, 696-697.

These cases are direct authorities for the proposition that a state tax upon the privilege of using an instrumentality of interstate commerce is invalid.

A state tax which **directly** burdens interstate commerce is invalid.[3] This principle applies whether the tax is upon the use of an instrumentality of interstate commerce, as in the *Helson* and *Bingaman* cases (279 U. S. 252; 297 U. S. 628, supra), or whether it is upon the occupation and business which constitutes such commerce, or upon the privilege of engaging in it, or upon the receipts derived from it.[4]

The primary question is whether the tax has a direct or an indirect bearing upon interstate commerce.[5] If direct, the tax is invalid (authorities supra) and is not saved by the fact that an equal tax is laid upon intrastate commerce.[6]

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[3]*Adams Mfg. Co. v. Storen* (1938) 304 U. S. 307; *Pacific Tel. Co. v. Tax Comm'n* (1936) 297 U. S. 403; *Cooney v. Mountain States Tel. Co.* (1935) 294 U. S. 384, 392; *Minnesota v. Blasius* (1933) 290 U. S. 1, 8-9; *Ozark Pipe Line v. Monier* (1925) 266 U. S. 555; *International Paper Co. v. Massachusetts* (1918) 246 U. S. 135, 141; *Kansas City Ry. v. Kansas* (1916) 240 U. S. 227, 231; *Western Union Tel. Co. v. Kansas* (1910) 216 U. S. 1, 27; *Erie Railroad v. Pennsylvania* (1895) 158 U. S. 431, 437; *Leloup v. Port of Mobile* (1888) 127 U. S. 640, 648; *Robbins v. Shelby Taxing District* (1887) 120 U. S. 489, 493-494.

[4]*Adams Mfg. Co. v. Storen* (1938) 304 U. S. 307, 313, 314; *New Jersey Tel. Co. v. Tax Board* (1930) 280 U. S. 338, 346; *Minnesota v. Blasius* (1933) 290 U. S. 1, 9; *Kansas City Ry. v. Kansas* (1916) 240 U. S. 227, 231, and many cases cited in the foregoing opinions and in note 3, supra.

[5]*Atlantic Lumber Co. v. Comm'r* (1936) 298 U. S. 553, 557; *Gregg Dyeing Co. v. Query* (1932) 286 U. S. 472, 478; *Hump Hairpin Co. v. Emmerson* (1922) 258 U. S. 290, 294-295; *Galveston, Harrisburg etc. Ry. Co. v. Texas* (1908) 210 U. S. 217, 227, and authorities notes 2, 3, 4, 6.

[6]"The opinion of the State Supreme Court stresses the generality and nondiscriminatory character of the exaction, but it is settled that this will not save the tax if it directly burdens interstate commerce" (*Adams Mfg. Co. v. Storen* (1938) 304 U. S. 307, 312).

"While a State may tax the privilege of engaging in local business, as it may regulate local rates, it may not tax the

The trial court in its original opinion also held that, **where property is used in a mingled interstate and intrastate commerce and a state tax is laid indiscriminately upon the use of the property, without apportionment as between the interstate and the intrastate use, the tax is invalid.** In so holding, the court applied the principle of *Cooney v. Mountain States Tel. Co.* (1935) 294 U. S. 384, in which this Court held that a state license tax on a telephone company was invalid where the company was engaged in intermingled interstate and intrastate commerce and where the tax was measured by the number of telephones used in the state, multiplied by a flat rate. The Court said (294 U. S. 393):

> "A privilege or occupation tax which a State imposes with respect to both interstate and intrastate business, through an indiscriminate application to instrumentalities common to both sorts of commerce,

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privilege of engaging in interstate commerce. Taxation being one of the forms of regulation, *Lehigh Valley R. Co. v. Pennsylvania,* 145 U. S. 192, 200, any tax laid directly upon the privilege is void even in the absence of legislation by Congress or a finding of prejudice" (*Pacific Tel. Co. v. Tax Comm'n* (1936) 297 U. S. 403, 412-413).

See also citations at 304 U. S. 312, note 11, and *Sonneborn Bros. v. Cureton* (1923) 262 U. S. 506, 515; *Spalding & Bros. v. Edwards* (1923) 262 U. S. 66, 69; *Fargo v. Michigan* (1887) 121 U. S. 230, 243-244; *Case of the State Freight Tax* (1872) 15 Wall. 232, 276-277.

It is only in the case of **indirect** burdens that the validity of the tax depends on whether it is excessive or is discriminatory as against the interstate commerce (*Gregg Dyeing Co. v. Query* (1932) 286 U. S. 472, 476, 478; *Armour & Co. v. Virginia* (1918) 246 U. S. 1, 7-8).

Since the tax in the case at bar is a direct burden, the question whether it discriminates against interstate commerce in other respects is academic. We do not concede, however, that the tax is nondiscriminatory.

has frequently been held to be invalid" (citing cases).[7]

The tax involved in the case at bar thus presents, for want of apportionment, the same legal question as if it had been laid upon property used exclusively in interstate commerce. Since a state tax upon the use of any of the means by which interstate commerce is carried on is a **direct** burden upon that commerce *(Helson and Randolph v. Kentucky* (1929) 279 U. S. 245, quoted supra, and authorities supra, note 2), there would seem to be no doubt that the tax is invalid as applied to the property in suit.

In all cases involving use taxes, which have arisen in the lower federal courts and which involved the application of the tax to the use of property in interstate commerce, the courts have held the tax invalid.[8]

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[7]Similarly, in *Adams Mfg. Co. v. Storen* (1938) 304 U. S. 307, this court held invalid a one per cent tax on the income from sales made within the state, saying (p. 314):

> "It is because the tax, forbidden as to interstate commerce, reaches indiscriminately and without apportionment, the gross compensation for both interstate commerce and intrastate activities that it must fail in its entirety so far as applied to receipts from sales interstate."

See also *Pacific Tel. Co. v. Tax Comm'n* (1936) 297 U. S. 403.

[8]*Southern Pac. Co. v. Corbett* (three-judge court, N.D. Cal., 1937) 20 F. Supp. 940 (No. 212, October Term, 1938, in this court, on the motion to dismiss. The trial court's reversal of opinion on final hearing did not affect its decision on the point here involved); *Northern Pac. Ry. Co. v. Henneford* (three-judge court, E.D. Wash., 1936) 15 F. Supp. 302 (reversed for want of jurisdictional amount (1938) 303 U. S. 17); *Mid-Continent Air Express Corporation v. Lujan* (three-judge court, D. N.M., 1931) 47 F. (2d) 266; *United States Airways v. Shaw* (three-judge court, W.D. Okl., 1930) 43 F. (2d) 148; *Minot v. Philadelphia, W. & B. R. Co.* (C.C. Del., 1870) 2 Abb. 323; Fed. Cas. No. 9,645, 17 Fed. Cas. 458, 463-465 (appeal as to this part of the case withdrawn, 18 Wall. 206, 211).

2. **The decision below**—The trial court commenced its second opinion on the final hearing in the railroad case by stating that appellant had established that **the use of the property here involved, without which its system would "stop running," is a use in interstate commerce.** But the court went on to say (23 F. Supp. 194; R. 80):

> "However, since our denial of the motion to dismiss, the Supreme Court has decided three cases dealing with the boundaries of state and federal taxation. Two of them, Western Live Stock v. Bureau of Revenue, 82 L. ed. [Adv. Op.] 548, and Coverdale v. Arkansas & Louisiana Pipe Line Co., decided April 4, 1938, significantly expand the area of the states. A third, Helvering v. Mountain Producers Corp., 82 L. ed. [Adv. Op.] 607, explicitly overrules long established concepts determining the respective taxing areas of both governments."

After discussing the last mentioned three decisions of this Court, the trial court deduced the following conclusion (23 F. Supp. 196; R. 84):

> "For the purposes of this case the dividing line is the same as in the Nashville and Edelman cases [288 U. S. 249; 289 U. S. 249] * * *. It is that the storage use and withdrawal use are prior to the actual installation of the parts and rails in the locomotive and cars and in the roadbed. Until then the increased cost, although it is paid by the passengers and freight owners, is an *'indirect'* burden on interstate commerce. Did not the Coverdale case seek to distinguish between the Nashville and Edelman cases and Helson v. Kentucky, 279 U. S. 345, we should be inclined to hold that the latter case was overruled and, though a direct burden, the tax was

as valid as the direct ad valorem tax on the railroad's property itself" (court's italics).

It is at once apparent that, with respect to the present case, involving telephone equipment, consisting of specific order equipment and stand-by property, the trial court's statement is applicable only to the stand-by property. Under the theory above stated by the trial court, the decree as to the specific order equipment, in any event, should have been for appellant, because there is no "storage use" or "withdrawal use" of that equipment prior to its actual installation in the interstate-intrastate telephone system. We refer to the particular facts in this connection:

3. **Specific order equipment**—Quoting from the findings:

"Specific order equipment, after the termination of the interstate shipment thereof, is installed either by plaintiff's employees or by experts in the employ of an agency hired by plaintiff to make specific installations" (R. 95). "There is no holding, in any warehouse, storeroom or other like place of deposit, of any of the specific order equipment after the termination of the interstate shipment" (R. 95). "The plaintiff orders all of the specific order equipment for immediate installation" (R. 92).

Since there is no storage of the specific order equipment, that equipment falls indistinguishably within the decisions of this Court, which have been cited. Specific order equipment is property of the same nature as that with respect to which this Court has said, in so many words, that its use in interstate commerce cannot be

subjected to a state tax. It consists, quoting again from the findings, "of central office switchboards, frames, cable racks, large private branch exchange switchboards, large underground cables, switches, central office cable, wire, protectors and other component parts of telephone and telegraph lines" (R. 92). In the *Helson* case, supra, in holding invalid a state tax on gasoline used in an interstate ferry, this Court said (279 U. S. 252):

> "The tax is exacted as the price of the privilege of using an instrumentality of interstate commerce. **It reasonably cannot be distinguished from a tax for using a locomotive or a car employed in such commerce.** A tax laid upon the use of the ferry boat, would present an exact parallel."

In *Bingaman v. Golden Eagle Lines* (1936) 297 U. S. 626, which involved a New Mexico use tax on gasoline, the *Helson* case was followed by a unanimous court (297 U. S. 628):

> "The case turns upon the question whether the pertinent statutory provisions exact a charge as compensation to the state for the use of its highways, or impose **an excise tax for the use of an instrumentality of interstate commerce.** If the former, the tax should be sustained; if the latter, it clearly **contravenes the commerce clause and must be held bad.** *Helson and Randolph v. Kentucky*, 279 U. S. 245, and cases cited."

The *Helson* case was cited with approval in *Eastern Air Transport v. Tax Comm.* (1932) 285 U. S. 147, 153; in *Gregg Dyeing Co. v. Query* (1932) 286 U. S. 472, 479; in *Nashville, C. & St. L. Ry. v. Wallace* (1933) 288 U. S. 249, 268; in *Edelman v. Boeing Air Transport* (1933) 289

U. S. 249, 253; and, at the last term of court, in *Coverdale v. Arkansas-Louisiana Pipe Line Co.* (1938) 303 U. S. 604, 611.

4. **Stand-by facilities**—The authorities which we have cited demonstrate, we submit, that the tax, as applied to the specific order equipment, is invalid. We submit that the case, considered not abstractly, but from a practical and realistic standpoint, is also clear with respect to the stand-by equipment. This consists of "small private branch exchange switchboards, teletypewriter equipment, cable, loading coils, poles, crossarms, wood conduits and a small amount of copper wire. Private branch exchange switchboards and teletypewriter printers comprise by far the largest part of the stand-by facilities" (Finding 29; R. 97).

Stand-by equipment is kept "to meet current requirements and the constantly fluctuating demands and emergencies which result from changes in the public demand for service and the repairs which from time to time are unavoidably made necessary * * * by reason of * * * unavoidable casualties and ordinary wear and tear" (Finding 32, R. 98).

The trial court found that a telephone system cannot operate without stand-by equipment and that stand-by equipment is **in use**. In its original opinion the court said (20 F. Supp. 946-947; R. 47-49):

> "Whether a use in storage for current consumption is a use in interstate commerce is a question of ultimate fact. Here the court must find or refuse to find this ultimate fact upon the admitted facts and upon those of which it takes judicial notice. It can-

not use 'artificial standards'. It must consider actual business and industrial concepts [citing 286 U. S. 472, 480; 297 U. S. 403, 413].

* * * * * * *

When we view realistically the facts set out in the bill, supplemented with our judicial notice of the practical necessities of a large transportation enterprise, we clearly perceive that this property is used in interstate commerce from the time of its purchase.

Consider first the property purchased for and devoted to a sole, fixed and predetermined use in an existing interstate commerce maintenance program. The storage of such property is a use which is as integral a part of the interstate commerce project as are the rails over which interstate trains are actually running.

* * * * * * *

Likewise, property purchased for the sole, fixed and predetermined purposes of serving as **'standby' or reserve equipment in an interstate commerce plant is employed in interstate commerce** from the time of its purchase. It is almost axiomatic that the far flung system of an interstate railroad cannot be conducted without the presence of reserve supplies. Unpredictable events requiring replacement and repair are of daily occurrence. A flood washes out a section of track. Can it rationally be argued that the rails and ties held in readiness against this emergency are not an integral portion of the company's interstate commerce equipment? One might as well contend that a derail switch is not in use in interstate commerce until an emergency requires it to function."

In its opinion on the final submission the court said (23 F. Supp. 194; R. 79):

"At the hearing we invited further argument and briefing, but the able presentation on behalf of the State has not answered the question, 'In what enterprise other than the intercommingled interstate and intrastate railroading is this use in storage for current repairs and replacements, without which the railroad could not operate?' **Such storage use for current installation is use in interstate commerce in any realistic sense** * * *."

5. **Cases relied on by the trial court**—The fact that the stand-by equipment is **in use** in the interstate system differentiates this case, we submit, from the three recent decisions of this Court, from which the trial court, on the final decree, concluded that the tax upon the use of stand-by property is not a **direct** burden upon interstate commerce. Those three cases all dealt with taxes on transactions **separate** from the interstate commerce or from the governmental function involved, and, of course, a tax on an intrastate transaction, separable from interstate commerce, even though closely related thereto, is an indirect burden on interstate commerce.

In *Western Live Stock v. Bureau of Revenue* (1938) 303 U. S. 250, the first of the three recent cases on which the trial court relied in reversing its original decision, this Court held that a state tax on the business of publishing a magazine, measured by the gross receipts from advertising contracts, fell upon something separate from the interstate distribution of the magazine because the business of preparing, printing, and publishing magazine advertising is peculiarly local and is distinct from interstate circulation.

In the second case, *Helvering v. Mountain Producers Corp.* (1938) 303 U. S. 376, the Court held that the federal income tax can be imposed upon the income derived by an individual from the sale of oil produced from land leased by him from the state, because such a tax upon the individual is an indirect, rather than a direct, burden upon the governmental function of the state in leasing the land.

In the third case, the *Coverdale* case (303 U. S. 604), this Court was considering a state privilege tax upon the production of mechanical power. The power there involved was ultimately used to operate compressors which increased the pressure of natural gas in an interstate gas pipe line. The Court held that the tax fell upon a transaction "just as much local as the generation of electrical power" (303 U. S. 611), and that the case was governed by such cases as *Utah Power & L. Co. v. Pfost* (1932) 286 U. S. 165. In the last mentioned case, this Court had decided that a state tax on the manufacture of electricity fell upon a process distinct from the transmission of the electricity in interstate commerce. This is very different from the proposition that stand-by equipment in an interstate telephone exchange is devoted to a use separable and distinct from the interstate telephone system. As already stated, the *Coverdale* case did not question the *Helson* case, but distinguished it, and we submit that there is the same basis of distinction between the *Coverdale* case and the case at bar.[9]

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[9]In the *Coverdale* case this Court said (303 U. S. 611-612):

"*Helson v. Kentucky*, 279 U. S. 245, *State Tax Commission v. Interstate Natural Gas Co.*, 284 U. S. 41, and *Cooney v.*

The facts of this case also differentiate it from the gasoline cases of *Nashville, C. & St. L. Ry. v. Wallace* (1933) 288 U. S. 249, and *Edelman v. Boeing Air Transport* (1933) 289 U. S. 249, 253, upon which the state officers put much reliance in the court below. Both these cases involve the **storage** or withdrawal from storage of gasoline which was thereafter used in interstate rail or airplane transportation. But in the present case there was no storage—**the stand-by property was in use** as stand-by equipment necessary to the operation of the interstate plant. The distinction noted by this Court in the *Coverdale* case as between the *Helson* case and the two cases cited by defendants is also applicable in the case at bar.[10]

Mountain States Tel. Co., 294 U. S. 384, are pressed upon us as controlling authorities for the invalidation of the tax. We think they belong to the category of cases which construe the state tax acts involved as taxes on interstate commerce and its instrumentalities rather than on operations closely connected with but distinct from that commerce. In the *Interstate* case and the *Cooney* case taxes levied on the business of engaging in interstate commerce were held invalid. Likewise, in the *Helson* case, this Court concluded that the tax on gasoline brought into the state and used on an interstate ferry was analogous to a tax on the use of the ferry itself in transit and therefore within the rule prohibiting state taxes on commerce."

Comparably, in this case the tax is a tax on the use of telephone switchboards and like property in interstate commerce, and therefore within the rule prohibiting state taxes on that commerce.

[10]In the *Coverdale* case the Court said (303 U. S. 612):

"A narrow distinction in fact exists between the tax held invalid in the *Helson* case and the valid tax considered in *Nashville, C. & St. L. Ry. Co. v. Wallace*, 288 U. S. 249, where a tax on gasoline brought into the state, stored and then used to drive engines in interstate transportation, was held valid. The storage and withdrawal was an intrastate, taxable event. See also *Edelman v. Boeing Air Transport*, 289 U. S. 249, 252; *Gregg Dyeing Co. v. Query*, 286 U. S. 472, 479."

A further distinction should be noted between the gasoline cases and the present case. The *Helson* case decided that a state tax could not be imposed upon the use of gasoline in an interstate ferry. The *Nashville* and *Edelman* cases held that storage and withdrawal of gasoline in the state prior to interstate use was "an intrastate, taxable event" (303 U. S. 612). In both the *Nashville* and *Edelman* cases large quantities of gasoline had been stored in the state; some of it, when segregated for the purpose, was subsequently used in interstate commerce. While the gasoline was in storage no one could tell its ultimate use. Gasoline is an ordinary mercantile commodity, the nature of which is not such as to bind it irrevocably during storage to a predestined interstate purpose.[11] But in the case at

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[11]These considerations in the two decisions under discussion were the determinative factors leading to the conclusion that the storage was a separate intrastate enterprise. The opinion in the *Nashville* case (upon which the *Edelman* decision is expressly based) states (288 U. S. 266):

> "Although in the usual course of business a variable and undefined part of it, when segregated for that purpose, would again be transported across state boundaries, appellant was free to distribute the oil either within or without the state for use in its business or for any other purpose. As nothing in the transaction before the withdrawal from storage in Tennessee can be said to have given any ascertainable part of the gasoline a destination to points beyond the state, the case is distinguishable from *Carson Petroleum Co. v. Vial*, 279 U. S. 95, and *Texas & New Orleans R. Co. v. Sabine Tram Co.*, 227 U. S. 111."

In the *Edelman* case the same decisive factors appeared, as shown by the facts recited in the opinion of the Circuit Court of Appeals (61 F. (2d) 319, 322):

> "• • • appellant sells some gasoline at Cheyenne and at Rock Springs; it displays a price sign at each place, stating the price of gasoline including the tax; other planes use both of these fields, and appellant uses gasoline locally at each field in trucks, automobiles, for testing purposes, and washing planes; there is no separate receptacle at either field in which

bar all of the property is manufactured specially and solely for use in telephone business, which is mingled interstate and intrastate, and the property, by reason of its special nature, cannot be diverted to any other use.[12] Moreover, there is no divertible surplus of stand-by facilities over and above the quantities which from time to time are actually necessary in the performance of the stand-by function; the stand-by facilities as well as the specific order equipment are purchased only at the times and in the quantities necessary to the efficient functioning of the intermingled interstate and intrastate business (Finding 15; R. 90). From every aspect, the maintenance of the telephone stand-by facilities in this case is unlike the storage of gasoline.

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appellant stores the gasoline which it sells to other airships, or buys outside Wyoming; it is all put into the storage tanks; there are gauges on the pumps, and a record was kept each time that gasoline was drawn from the tanks; the amount used locally by appellant, or sold, is in this way kept separately from the amount used by appellant in its interstate flights; it likewise measures the gasoline put into its planes for interstate commerce use."

[12] "All of the specific order equipment is especially designed for use in the operation of a telephone and telegraph system, and is peculiarly adapted to telephone and telegraph uses and is not suitable for any other use" (Finding 23; R. 94).

"All of such stand-by facilities are especially designed for use in the operation of a telephone and telegraph system, and are peculiarly adapted to telephone and telegraph uses and are not suitable for any other use" (Finding 29; R. 97).

"* * * plaintiff does not divert and has no practical way of diverting any of said articles to any use other than their intended use in plaintiff's said inextricably intermingled interstate and intrastate telephone and telegraph commerce and business" (Finding 16; R. 90).

B. PROPERLY CONSTRUED, THE STATUTE DOES NOT TAX THE USES HERE SHOWN.

Before concluding, we point out that though the appellants have sought to collect the use tax here in suit, there is no decision of the state courts which binds this Court to hold that the Act was intended to, or does, apply to the facts here presented.

As already noted, the statute imposes a tax upon the use of tangible personal property "**in this State**." By reason of the nature of telephone property—switchboards, teletypewriters, and other instrumentalities of telephone service—its use takes place not wholly "in this State," but also outside the state; the use and service of each instrumentality necessarily extends outside of the state. The statute does not provide a tax on use **originating** in the state, but on use **in** the state; it specifically provides, among its definitions, that "'in this State' or 'in the State' means **within the exterior limits** of the State of California." A part of the use of appellant's property is, therefore, expressly and necessarily excluded from the taxing provisions of the statute; consequently, since the statute makes no provision for any separation of this part of the use, it cannot properly be held to impose the tax in suit. This follows, we submit, from the provisions of the statute, independently of any provision of the Federal Constitution. If the statute were construed otherwise—that is, as attempting to tax the use of telephone property which, by the nature of the property and of its use, necessarily occurs in part in other states—it would be given an extraterritorial operation beyond the jurisdiction of the state, which would be contrary not only to the commerce

clause, but also to the Fourteenth Amendment. Without jurisdiction there cannot be due process of law (*Conn. General Co. v. Johnson* (1938) 303 U. S. 77, 80-81; *James v. Dravo Contracting Co.* (1937) 302 U. S. 134, 138-139; *Atl. & Pac. Tea Co. v. Grosjean* (1937) 301 U. S. 412, 424).

The trial court noted the provision in section 4(b) of the statute excluding from its operation any storage, use or other consumption of property which the state is prohibited from taxing under the Federal Constitution, saying (20 F. Supp. 946; R. 47):

> "While this does no more than declare what already is the law, it demonstrates the solicitude of the legislature toward the recognition of constitutional limitations. It indicates that when the legislature defined taxable storage and use it was anxious to insure that interstate commerce use would be protected."

The trial court then went on to point out that the construction urged by appellees requires the court to read into the statute provisions and distinctions which it does not contain (20 F. Supp. 947-948; R. 49-51).

The administrative regulations on the use tax adopted by the State Board of Equalization (whose members are among the appellees), issued July 1, 1935, and revised October 1, 1936, give a construction to the statute opposed to that for which the appellees contend in this case. Ruling No. 11 (R. 102) provides that:

> "The fact that tangible personal property is used in this State in interstate or foreign commerce **following its storage in this State** does not exempt the **storage** of the property from tax."

This regulation construes the state law as not applying to the use of property in interstate service unless there is a preliminary storage in California, in which event the tax is levied on the storage.

In the present case, as already shown, since the only "storage" appearing in the case—the maintenance of stand-by facilities—has been found to be a use in interstate commerce, there is no storage in California of any of the property under consideration prior to its use in interstate commerce.

Since the validity of the tax has not been decided by the state courts, this Court has jurisdiction to consider its validity under the state law as well as under the Federal Constitution (*Hopkins v. Southern Cal. Tel. Co.* (1928) 275 U. S. 393; *Glenn v. Field Packing Co.* (1933) 290 U. S. 177).

CONCLUSION.

This Court has often held that " 'The question of constitutional validity is not to be determined by artificial standards' " (*Pacific Tel. Co. v. Tax Comm'n* (1936) 297 U. S. 403, 413). It has held that the "validity of the tax is to be determined by the practical effect of enforcement" (*Graves v. Texas Company* (1936) 298 U. S. 393, 400-401). The present case involves specially designed equipment, useful only for the purpose of rendering telephone service in intermingled interstate and intrastate commerce—equipment which appellant orders, obtains and uses only for that purpose. The tax upon the use of such property,

capacity, is a direct tax upon interstate commerce, which, we submit, the state statute did not intend to impose, but which, if sought to be imposed, would render the statute unconstitutional in that respect, there being no apportionment of the amount of the tax according to the proportion of intrastate use. As to the property involved in the case at bar, consisting of the specific order equipment and the stand-by facilities, we submit that the tax clearly is invalid.

We respectfully submit that the decree should be reversed with instructions to the trial court to grant the relief sought by appellants.

Dated, San Francisco, California,
November 16, 1938.

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(Appendix Follows.)



Appendix

PERTINENT PORTIONS OF THE CALIFORNIA USE TAX ACT OF 1935 (Cal. Stats. 1935, p. 1297, ch. 361; Material in Brackets Added by Cal. Stats. 1937, p. 1935, ch. 683):

Sec. 2. The following words, terms and phrases when used in this act have the meanings ascribed to them in this section, except where the context clearly indicates a different meaning.

(a) "Storage" means and includes any keeping or retention in this State for any purpose except sale in the regular course of business [or subsequent use solely outside this State] of tangible personal property purchased from a retailer.

(b) "Use" means and includes the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it shall not include the sale of that property in the regular course of business.

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(j) "In this State" or "in the State" means within the exterior limits of the State of California, and includes all territory within such limits owned by or ceded to the United States of America.

Sec. 3. An excise tax is hereby imposed on the storage, use or other consumption in this State of tangible personal property purchased from a retailer on or after July 1, 1935, for storage, use or other consumption in this State at the rate of three per cent of the sales price of such property.

Every person storing, using or otherwise consuming in this State tangible personal property purchased from a

retailer shall be liable for the tax imposed by this act, and the liability shall not be extinguished until the tax has been paid to this State; * * *.

Sec. 4. The storage, use or other consumption in this State of the following tangible personal property is hereby specifically exempted from the tax imposed by this act:

(a) Property, the gross receipts from the sale of which are required to be included in the measure of the tax imposed by Chapter 1020, Statutes of 1933, and any amendments made or which may be made thereto.

(b) Property, the storage, use or other consumption of which this State is prohibited from taxing under the Constitution or laws of the United States of America or under the Constitution of this State.

* * * * * * *

Sec. 6. Every retailer maintaining a place of business in this State and making sales of tangible personal property for storage, use or other consumption in this State, not exempted under the provisions of section 4 hereof, shall, at the time of making such sales [or, if the storage, use or other consumption of the tangible personal property is not then taxable hereunder, at the time such storage, use or other consumption becomes taxable hereunder,] collect the tax imposed by this act from the purchaser and give to the purchaser a receipt therefor in the manner and form prescribed by the board. The tax required to be collected by the retailer from the purchaser shall be displayed separately from the list, advertised in the premises, marked or other price on the sales check or other proof of sales.

Sec. 7. The tax imposed by this act shall be due and payable to the board quarterly on or before the fifteenth

day of the month next succeeding each quarterly period during which the storage, use or other consumption of tangible personal property became taxable hereunder, the first of such quarterly periods being the period commencing with the first day of July, 1935, and ending on the thirtieth day of September, 1935. Every retailer maintaining a place of business in this State shall on or before the fifteenth day of the month following the close of the first quarterly period as above defined, and on or before the fifteenth day of the month following each subsequent quarterly period of three months, file with the board a return for the preceding quarterly period in such form as may be prescribed by the board showing the total sales price of the tangible personal property sold by the retailer, the storage, use or consumption of which became subject to the tax imposed by this act during the preceding quarterly period, and such other information as the board may deem necessary for the proper administration of this act. The return shall be accompanied by a remittance of the amount of tax herein required to be collected by the retailer during the period covered by the return. The board, if it deems it necessary in order to insure payment to the State of the amount of tax herein required to be collected by retailers, may require returns and payment of such amount of tax for other than quarterly periods. Returns shall be signed by the retailer or his duly authorized agent but need not be verified by oath.

Every person purchasing tangible personal property, the storage, use or other consumption of which is subject to the tax imposed by this act, and who has not paid the tax due with respect thereto to a retailer required or

authorized hereunder to collect the tax, shall on or before the fifteenth day of the month following the close of the first quarterly period as above defined, and on or before the fifteenth day of the month following each subsequent quarterly period of three months, file with the board a return for the preceding quarterly period in such form as may be prescribed by the board showing the total sales price of the tangible personal property purchased by such person, the storage, use or other consumption of which became subject to the tax imposed by this act during the preceding quarterly period and with respect to which the tax was not paid to a retailer required or authorized hereunder to collect the tax, and such other information as the board may deem necessary for the proper administration of this act. The return shall be accompanied by a remittance of the amount of tax herein imposed and not paid to a retailer required or authorized hereunder to collect the tax during the period covered by the return. The board, if it deems it necessary in order to insure payment to the State of the amount of such tax may require returns and payment for other than quarterly periods. Returns shall be signed by the person liable for the tax or his duly authorized agent but need not be verified by oath.

SUMMARY OF THE FINDINGS OF FACT.

Appellant is a California corporation engaged exclusively in furnishing telephone[1] service in and between California and other states (R. 85, 87). Its business con-

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[1]In this summary of the findings, as in the brief, "telephone" is used for "telephone and telegraph."

sists of inextricably intermingled interstate and intrastate commerce, and its system, plant and operating capital are exclusively devoted inseparably and indiscriminately to interstate and intrastate service, the same plant, facilities and organization being devoted indiscriminately to and used indiscriminately in interstate and intrastate service (R. 85, 87-88). It is not feasible to provide separate telephone systems, one for interstate and the other for intrastate business (R. 87).

Appellees are the state officers charged with the enforcement of the California Use Tax Act of 1935 (R. 85-86).

In the conduct of its business, appellant purchases from a manufacturer outside of California necessary equipment, apparatus, materials and supplies for use exclusively in its business (R. 88). All of the articles purchased are necessary to the efficient and economic operation of appellant's telephone system, and the purchases are made at the times and in the amounts necessary to meet the needs of the business (R. 90). The manufacturer ships the property in interstate commerce to appellant at various points in California (R. 88).

The property purchased is of two general classes: "specific order equipment," i. e., that purchased on specific orders and made to order for a specific place and purpose in the telephone system, and on its arrival in California installed and used without intervening storage (R. 88-89, 92-96), and "stand-by facilities," which on arrival in the state are held in a stand-by capacity for installation to meet public demands and emergencies and to make repairs, so as to insure continuity of telephone

service (R. 89, 97-99). Appellant orders specific order equipment for immediate installation, and delivery is timed so that installation can proceed immediately (R. 92, 95). Specific order equipment is never held in any warehouse, storeroom or other like place of deposit (R. 95). There is no holding or retention of any of the specific order equipment except such as necessarily occurs in the ordinary and efficient course of transporting the property to its ultimate destination and installing it into the telephone plant (R. 96), and the same is true of stand-by facilities after they are taken from appellant's stores (R. 99). The distribution of stand-by facilities to stores located at strategic points over the system and the holding of the stand-by facilities in these stores is necessary to insure the rendition by appellant, as efficiently and as free from interruption as possible, of interstate and intrastate telephone service (R. 98).

All of the property involved is purchased with operating capital (R. 90), and is accounted for as operating property from the date of its purchase, the purchase price and cost of installation being charged to appropriate accounts of material and supplies, plant, or operating expense, in accordance with the rules prescribed by the Federal Communications Commission (R. 90-92, 100).

All of the property is specially designed for use in a telephone system, is peculiarly adapted to telephone uses, and is not suitable for any other use (R. 94, 97).[2]

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[2]A small number of exchange telephone poles are especially designed for joint use, under joint pole agreements, with power companies, light companies, etc., for carrying appellant's telephone and telegraph wires and also the wires of such other companies. The purchase and use of joint poles in this manner is an ordinary

The property, by reason of its nature and by reason of the purpose for which and the particular specifications according to which it is manufactured, is not readily or practically salable by appellant to others, and appellant does not divert and has no practical way of diverting any of it to any other than the telephone use for which it is purchased (R. 90). Appellant uses all of the property exclusively in the operation and maintenance of its telephone system, and indiscriminately and in common for interstate and intrastate commerce (R. 100).

By reason of the intermingled interstate and intrastate business, appellant is compelled to purchase a greater amount of the property subjected to the tax, than it would be required to purchase if it were engaged only in intrastate business (R. 101).

[Further findings relate to the equity jurisdiction of the trial court, which is not here questioned.]

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and customary practice in the conduct of telephone and telegraph business. Appellant uses its part of the joint poles exclusively in its telephone and telegraph business, by means of crossarms and other equipment peculiarly adapted to telephone and telegraph uses and not suitable for any other use (R. 94-95).